Global markets plunge on fears of deeper slump

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Stock markets in the US and internationally closed sharply lower yesterday amid growing fears of a "double-dip" recession. A worse than expected American trade deficit, the downward revision of US gross domestic product (GDP) growth, slowing growth in China, and evidence of Federal Reserve fears of deflation all contributed to the financial markets' anxiety.

On Wall Street, the Dow Jones Industrial Average fell 265 points, closing 2.5 percent lower. The Standard & Poor's 500 index lost 2.8 percent and the technology-based Nasdaq fell by 3 percent.

On the Dow, financial and industrial stocks declined most sharply, particularly those that are highly exposed to trends in the global economy. Alcoa lost 6.1 percent, Boeing 4.4 percent, and Caterpillar 3.8 percent. All three of the leading US indexes now stand lower than they did at the beginning of the year.

Other markets plunged by similar levels. In Britain, the FTSE 100 was down 2.4 percent. The German DAX declined 2.1 percent, and the French CAC 40 fell 2.7 percent.

Asian indexes were mostly lower. The euro lost 2.3 percent of its value against the dollar as investors shifted to perceived safer assets, including US Treasuries. The Chicago Board Options Exchange Volatility Index, often referred to as the "fear gauge," leapt by 17 percent.

The market losses follow the US Federal Reserve decision Tuesday to direct the revenues from its maturing mortgage debt, mortgage-backed securities and Treasury bills into new Treasury securities, instead of allowing its $2.3 trillion balance sheet to decline. The move was intended to reassure the financial sector that the Fed's near-zero official interest rates would remain in place for the foreseeable future, and that a resumption of the quantitative easing program—effectively printing money to purchase Treasuries and mortgage bonds—would be considered in the event of another serious contraction in economic activity. (See: "US Federal Reserve reassures markets, offers no help to the unemployed")

For many investors and speculators, the Federal Reserve's announcement had the opposite effect of what had been intended. Instead of reassurance, it sparked widespread concern.

"The Fed's actions yesterday realigned the stars and changed the narrative from one where people were relatively confident that the recovery was intact and didn't require much of a policy response," David Gilmore of Foreign Exchange Analysts told the *Wall Street Journal*. Investors are now asking, Gilmore continued, "What does the Fed know that we don't?"

Joe Battipaglia, a market strategist with Stifel Nicolaus, told the *New York Times*: "It actually shakes confidence and raises questions about the future. What kind of economy do we have that requires more quantitative easing?"

Several commentators said the Fed's move raised the spectre of a prolonged deflationary period. "The comparisons to Japan keep coming back," David Owen, chief European financial economist at Jefferies in London, told the *Wall Street Journal*. "What the Fed is doing, by trying to drive down the yield curve, draws a parallel with Japan. In Europe, inflation is low and deflation risk is facing many countries."

The Commerce Department reported yesterday that the US trade deficit jumped nearly 19 percent for June, to $49.9 billion. This is the largest deficit recorded since the financial crash of September-October 2008 and exceeded economists' forecasts. Imports were up 3 percent while exports declined by 1.3 percent.

The trade figures, combined with a drop in factory inventories reported last week, triggered predictions that estimated US GDP growth for the second quarter would be downwardly revised. The original government estimate was 2.4 percent.

Nigel Gault of IHS Global Insight told the *New York Times* that the trade deficit, combined with other weak data, suggested that second-quarter growth was just 1.2 percent, or half the initial official calculation, "placing the economy on even shakier ground than it seemed, and underlining why the Fed has shifted towards an easing bias."

Some economists have suggested that the actual growth rate is even lower. The *Wall Street Journal* cited Peter Newland of Barclays Capital saying that his firm's tracking estimate for second-quarter GDP growth now stands at just 0.3 percent. The world's largest economy may have remained virtually stagnant despite President Barack Obama's stimulus measures and boasts of a recovery underway.

There are mounting signs of renewed trouble in the global economy. New data from China indicated a cooling economy, including slower growth in retail sales and fixed asset investment. Weaker import figures were also reported this week, pointing to the Chinese economy's continued dependence on foreign export markets.

The Bank of England yesterday cut its forecast for annual growth in Britain for 2010 from 3.6 percent to 3 percent. The revision was attributed to the failure of the banks to significantly increase domestic lending and uncertainty with regard to the US and European economies.

Despite signs of a renewed global economic contraction, governments around the world are maintaining their coordinated turn away from fiscal stimulus measures in favour of austerity. The priority remains making the working class pay for the deficits and debts racked up by the bank bailouts and the stimulus spending programs, which were directed towards boosting targeted sections of business. Public spending is being slashed in key areas including health, education, social infrastructure and public-sector jobs and wages. In the US, Europe and other advanced capitalist economies, the aim is permanently reducing the living standards of working people.

At the same time the banks and financial institutions which are responsible for the crisis have been assured that they will be shielded in the event of a double-dip recession in the US and world economy. This week's decision of the Federal Reserve to keep its cash in the treasury market spooked investors, but it has also had the effect of raising market expectations of a massive government intervention if this becomes necessary to maintain Wall Street profits.